IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

COMPANY APPLICATION No. 235 of 2005
In
COMPANY PETITION No. 207 of 2001

For Approval and Signature:

HONOURABLE MR.JUSTICE M.R. SHAH

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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ASSISTANT COMMISSIONER OF INCOME TAX - Applicant(s)
Versus
O.L.OF MINAL OIL & INDUSTRIES LTD. & 4 - Respondent(s)

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Appearance :

MR MANISH R BHATT for Applicant(s) : 1,
OFFICIAL LIQUIDATOR for Respondent(s) : 1,
SINGHI & CO for Respondent(s) : 2,
MR ANIP A GANDHI for Respondent(s) : 3,
MS NALINI S LODHA for Respondent(s) : 4,
NANAVATI ASSOCIATES for Respondent(s) : 5,

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CORAM : HONOURABLE MR.JUSTICE M.R. SHAH

Date : 13/06/2006

CAV JUDGMENT

1. By way of this petition, the applicant – Assistant Commissioner of Income Tax, Central Circle -1(1),

Ahmedabad has prayed for an appropriate order directing the Official Liquidator of Shri Minal Oil and Industries Limited (in liquidation) to make payment of the outstanding demand of the Income tax Department, treating it to be a creditor of the company in liquidation, as per the provisions of Section 178(2) of the Income Tax Act, 1961 (hereinafter referred to as “the Act”). By way of an amendment, the applicant has amended the prayer clause and has prayed for an appropriate order directing the Official Liquidator to set apart the amount of tax dues, as per the provisions of Section 178(2) of the Act and to comply with the provisions and the procedure enumerated under Section 178 of the Act.

2. The short question, which is required to be considered by this court is whether the tax liabilities like income tax has preference over the rights of the secured creditors and workers in so far as the sale proceeds of the company in liquidation or not? In other words, considering Section 178 of the Act, for the tax liabilities, the dues of income tax can have the priority and/or whether Section 178 of the Act makes a claim of the Income tax department for income tax dues a preferential rights over the rights of the other

creditors under Section 529(A) of the Companies Act?

3. Shri Minal Oil and Agro Industries Private Limited (now in liquidation) was ordered to be wound up vide order dated 15th January, 2003 in Company Petition No.207 of 2001 passed by this court (Coram: A.R. Dave, J.). Thereafter, this court (Coram: M.S. Shah, J.) vide order dated 2-12-2003 in OLR No.46 of 2002 was pleased to direct *inter alia* that a sale committee be constituted and upon realization of the sale proceeds, the same would be paid to respondent No.2 herein i.e. Export Import Bank of India after deducting expenses. That thereafter, the sale in favour of one Kanak for Rs.23.80 crore came to be confirmed by this court (Coram: D.A. Mehta, J.) dated 20-2-2004 specifying the schedule of payment of sale consideration of Rs.23.80 crore. That as per said order, an amount of Rs. 10 crore was to be paid to respondent No.2 in two installments of Rs.5 crore, payable on or before 31st March, 2004 and 31st May, 2004 subject to the deduction as stated in the said order and the balance payment was required to be paid within a period of five years in five annually installment after a moratorium of two years and the said Kanak was required to secure the balance payment of Rs.13.80 crore by way of a bank

guarantee. It appears that said Kanak made the payment of Rs.10 crore as aforesaid and furnished the unconditional bank guarantee of Rs.13.80 crore. That the applicant has preferred the present company application for the aforesaid relief i.e. directing the Official Liquidator of the aforesaid company in liquidation to set aside the amount of tax dues as per the provisions of Section 178(2) of the Act by contending *inter alia* that the applicant is the Assessing Officer of the company in liquidation and the block assessment order under Section 158-BC read with Section 144 was passed on 16-10-2003 and the undisclosed income was determined at Rs.65.49 crore and the assessee filed an appeal before the CIT(A) and he passed order dated 20th January, 2005 in which he deleted the addition to the extent of Rs.48.81 crore and the net undisclosed income is determined at Rs.16.67 crore after giving effect to the order of CIT(A) dated 3rd February, 2005 and the demand after this effect has been determined at Rs.10.32 crore and thus, Rs.10.32 crore is the total outstanding dues/demand in case of the assessee. It is also further contended in the application that for recovery of the demand, the applicant has notified the Official Liquidator as per the provisions of Section 178(2) of the Act under letters dated 30-1-2004 and 3-9-

2004 and the Official Liquidator under letter dated 8-9-2004 has informed the applicant that the factory site including land, building and machinery have been sold through the public auction for Rs.23.80 crore in pursuance of the orders passed by this court and that the entire sale proceeds received in this regard is to be disbursed in favour of respondent No.2 herein i.e. Export Import Bank of India as per the court's order and that the claim of the department as per the provisions of the Companies Act, 1956 will be settled in case of surplus fund is available. The Official Liquidator has also informed the applicant that as per the provisions of the Companies Act, the secured creditors i.e. all secured banks/institutions and workers will have first P*ari Passu* charge over the said amount assets and their claim will be settled in full in the first order. Therefore, the applicant has preferred the present company application for the aforesaid relief relying upon the decision of the Hon'ble Supreme Court in the case of **Imperial Chit Funds (P) Limited V. Income Tax Officer, Ernakulam** reported in AIR 1996 SC 1887 = 219 ITR 498.

4. Shri MR Bhatt, learned counsel appearing on behalf of the Income tax department has submitted that in view

of the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra), the Income tax department is a secured creditor and considering the provisions of Section 178(2) of the Act, on notifying to the Official Liquidator the claim of the department, the Official Liquidator is required to set aside the amount notified at the first instance and then and then only the balance amount is required to be disbursed amongst other secured creditors and the workers. It is submitted by him that the Income tax department notified the Official Liquidator the demand of the Income tax department as per the provisions of Section 178(2) of the Act under letters dated 30-1-2004 and 3-9-2004 and the Official Liquidator was bound to set aside the amount notified under the aforesaid letters and therefore, it is requested to grant the relief as prayed for directing the Official Liquidator to set aside the amount of tax dues as per the provisions of Section 178(2) of the Act. It is submitted by him that in fact as per Section 178(1) of the Act, the Official Liquidator was required to give notice of his appointment to the Assessing Officer, which the present Official Liquidator has failed to inform. It is further submitted that once the claim is notified by the department, the Official Liquidator is duty bound to set

aside the amount so notified and only thereafter, and with regard to the balance amount, if any, the same can be disbursed amongst the other creditors inclusive of workers. Relying upon the judgment of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra), it is submitted that as held by the Hon'ble Supreme Court, Income tax department is a secured creditor and when the company is wound up as per the orders of the High Court and after the commencement of the winding up proceedings the Income tax officer finalizes the assessment of the company, the income tax officer need not wait and prove his claim before the Official Liquidator when the list of creditors is settled and the effect of Section 178(3)(b) is that the amount “set aside” by the Liquidator is marked off as outside the area of winding up proceedings and the jurisdiction of the winding up court. Therefore, it is submitted that the dues of the Income tax department would be having preference/priority against other creditors. Shri Bhatt has also relied upon the judgment of the Andhra Pradesh High Court in the case of **Income Tax Officer, B-Ward, Company Circle, Hyderabad V. Official Liquidator** reported in 101 ITR 470 and has submitted that as held by the Andhra Pradesh High Court, the Income tax liabilities of

the company in liquidation is entitled to preferential treatment and under Section 178 of the Act, the Official Liquidator of a company under liquidation is under an obligation to set apart the entire income tax liabilities of the company, as notified by the Income tax officer, before the distributing assets of the company to the other unsecured creditors. Therefore, it is requested to grant relief as prayed for.

5. The present application is opposed by respondent No.2 and an affidavit-in-reply is also filed on behalf of respondent No.2. It is submitted that the application itself is misconceived and not maintainable in view of the fact that proviso to Section 178(3) of the Act itself provides that the liquidator is not debarred from making any payment to secured creditors, whose debts are entitled under the law to priority of payment over debts due to Government on the date of liquidation and Section 529(A) of the Companies Act read with Section 529 of the Companies Act provide priority to the secured creditors and workmen only while, *inter alia*, all revenue, taxes, cesses and rates etc. are to be paid under section 530 of the Companies Act. It is also submitted that for the purpose of a company in liquidation and payment of sale

proceeds of the said company, all Government dues are to be treated as unsecured debts payable under Section 530 of the Companies Act. It is also further submitted that in fact pursuant to the order passed by the learned Company Judge and on finalization of the sale in favour of one Kanak, the purchaser was required to first deposit an amount of Rs.10 crore towards the sale proceeds and the same was required to be paid to respondent No.2 in two installments of Rs.5 crore, which respondent No.2 has already received and therefore, nothing remains with the Official Liquidator for making any alleged payment for any alleged dues of the applicant. It is also further submitted that in fact, the Income tax department ought not to have proceeded further with the assessment without the prior permission of the learned Company Judge as required under Section 446 of the Companies Act and that when the company was already ordered to be wound up by order dated 15-1-2003 and the Official Liquidator was appointed as provisional Liquidator of the company in liquidation, it is not known as to how the company could have filed an appeal before the CIT(A). It is submitted that it is further surprising that the applicant proceeded to give effect to the order dated 3-2-2005 of CIT(A) against the company, which was already wound up.

According to respondent No.2, the action on the part of the Income tax department would be in contravention of the provisions of the Act and thus would be *void ab initio*. On merits, it is also further submitted that and respondent No.2 has disputed the contention on behalf of the petitioner that considering the provisions of Section 178(2) of the Act, the Official Liquidator is required to set aside the dues of the Income tax department and that the dues of the Income tax department would have preference and/or priority over the other creditors. It is also further submitted that reliance placed upon the judgment of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited is misconceived, as the question/controversy before the Hon'ble Supreme Court was with regard to claims of the creditors under Section 530 of the Companies Act and before the Hon'ble Supreme Court, the claim of the Income tax department against the secured creditors as envisaged under Section 529(A) of the Companies Act was not under consideration. Shri Joshi, learned senior counsel appearing for respondent No.2 has relied upon the judgment of the Bombay High Court in the case of **Syndicate Bank and etc. V. The Official Liquidator, Mumbai and others** reported in AIR 1999 Bombay 243 as well as the judgment of the Kerala

High Court in the case of **Venad Pharmaceuticals and Chemicals Limited (in liquidation), *In re*** and another reported in (2003) 114 Company Cases page 185 and relying upon the aforesaid two decisions, it is submitted that the Bombay High Court as well as Kerala High Court after considering the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra), have held that the dispute before the Hon'ble Supreme Court was not under Section 529(A) of the Companies Act i.e. over the secured creditors and it is further held that rights of the secured creditors and workers as set out under Section 529(A) of the Companies Act, would override the claims of the tax authorities in respect of an order made under Section 178 of the Act.

6. Meeting with the contention on behalf of the applicant that on notifying the claim by the Assessing Officer with the Official Liquidator under Section 178(2) of the Act, the liquidator is required to set apart the said amount notified by the Assessing Officer and that the dues of the Income tax department will have preference/priority over other creditors, Shri Joshi has submitted that even as per Section 178(3) of the Act, more particularly, proviso to subsection (3) of Section

178, it is open for the Official Liquidator to part with such assets or properties for the purpose of payment to other secured creditors whose debts are entitled under the law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company. Therefore, it is submitted that the contention on behalf of the applicant that the dues of the Income tax department will be having preference/priority over the other secured creditors envisaged under Section 529(A) of the Companies Act, has no substance. Shri Joshi has also relied upon the judgment of the Division Bench of this court in the case of **Board and Papers Mills Limited (in liquidation) V. Income Tax Officer, Circle I, Ward-E, Ahmedabad and Others** reported in (1976) 46 Company Cases page 25. However, the said decision is overruled by the Hon'ble Supreme Court in the decision of Imperial Chit Funds (P) Limited (supra). For all these reasons, it is requested to dismiss the present application.

7. The Official Liquidator has submitted its report and has also opposed the present application and has in fact adopted the arguments and the submissions made on behalf of respondent No.2.

8.Heard the learned advocates appearing on behalf of the parties.

9. As stated above, the dispute in the present application is whether considering the provisions of Section 178(2) of the Act, the dues of the Income tax department would have any preference/priority over the dues of the secured creditors as envisaged under Section 529(A) of the Companies Act? and/or on notifying the claims of the Income tax department by the Assessing Officer to the Official Liquidator, the Official Liquidator is required to set apart the amount due towards the claims of the Income tax department? and only thereafter the balance amount can be disbursed amongst other creditors? The learned counsel appearing for applicant – Income tax department has heavily relied upon Section 178(2) of the Act as well as the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra). Relying upon the decision of the Hon'ble Supreme Court, it is submitted that the Income tax department is a secured creditor and on notifying the claim by the Assessing Officer, the Official Liquidator is required to set aside the said amount first and the dues of the Income tax department would have

preference/priority over other secured creditors. It is required to be noted and on going through the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra), it appears that the issue, whether an order passed under Section 178 of the Act would have preference over the rights of the secured creditors as envisaged under Section 529(A) of the Act, was not the issue before the Hon'ble Supreme Court and what was the issue before the Hon'ble Supreme Court was *qua* Section 530(1)(a) i.e. other unsecured creditors and it is in that context, considering the provisions of Section 178 of the Act, the Hon'ble Supreme Court held that if an order was passed under Section 178 of the Income tax Act,1961 bearing in mind that the amendment was brought by the Income tax Act, 1961 and considering the equality amongst the creditors as set out in Section 530(5) of the Companies Act, an order under Section 178 for Income tax dues would have preference over other unsecured creditors set out in Section 530(1).

10. In order to appreciate the controversy in question,, it will be useful to bear in mind the relevant provisions of the Act and the Companies Act, 1956. The relevant provisions are extracted hereinbelow:

Income-tax Act, 1961

"178. Company in liquidation.-- (1) Every person --

(a) who is the liquidator of any company which is being would up, whether under the orders of a court or otherwise; or
(b) who has been appointed the receiver of any assets of a company (hereinafter referred to as the liquidator)shall, within thirty days after he has become such liquidator, give notice of his appointment as such to the Assessing Officer who is entitled to assess the income of the company.
(2) The Assessing Officer shall, after making such inquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.
(3) The liquidator--
(a) shall not, without the leave of the Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer under sub-section (2);and
(b) on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands;
Provided that nothing contained in this sub-section shall debar the liquidator from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such and expenses of the winding up of the Company such costs and expenses of the winding up of the company as are in the opinion of the Chief Commissioner or Commissioner reasonable.
(4) If the liquidator fails to give the notice in accordance with sub-section (1) or fails to set aside the amount as required by sub-section (3) or parts with any of the assets of the company or the properties in his hands in contravention of the provisions of that sub-section, he shall be personally liable for the payment of the tax which the company would be liable to pay :

Provided that if the amount of any tax payable by the company is notified under sub-section (2), the personal liability of the liquidator under this sub-section shall be to the extent of such amount.
(5) Where there are more liquidators than one, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.
(6) The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force."

(Emphasis supplied)

Companies Act, 1956

529.A. (1) Notwithstanding anything contained in any other provision of this Act or any other law for the time being in force, in the winding up of a company--
(a) workmen's dues; and
(b) debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub-section (1) of Section 529 *pari passu* with such dues,
shall be paid in priority to all other debts.

(2) The debts payable under clause (a) and clause (b) of sub-section (1) shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.”

530.(1) In a winding up, subject to the provisions of Section 529 A, there shall be paid in priority to all other debts--
(a) all revenues, taxes, cesses and rates due from The company to the Central or a State Government or to a local authority at the relevant date as defined in clause (c) of sub-section (8), and having become due and payable within the twelve months next before that date;"

Therefore, even considering the proviso to Section 178(3) of the Act, the Official Liquidator is not

debarred from making any payment to secured creditors, whose debts are entitled under the law to priority of payment over debts due to Government on the date of liquidation. Thus, the said provision itself provides that payment can be made to secured creditors having priority in law over the Government. Therefore, the contention on behalf of the applicant that on notifying the claim by the Assessing Officer under Section 178(2) of the Act, the Official Liquidator is required to set apart the said amount and only thereafter the balance amount can be disbursed amongst other secured creditors, cannot be accepted. If such interpretation is given, the same would be contrary to proviso to subsection (3) of Section 178 of the Act. Under the circumstances, the contention on behalf of the applicant to that effect is required to be rejected. If Section 529(A) of the Companies Act, 1956 is considered, it is clear that it has an overriding effect. Section 529(A) of the Companies Act was brought in by an amendment and was inserted in the Companies Act by Act of 1985. The said section makes it clear that notwithstanding anything contained in any other provision of this Act or any other law for the time being in force, dues of the workers and the debts due to secured creditors to the extent such debts rank under

clause (c) of the proviso to sub section (1) of Section 529 P*ari Passu* with such dues shall be paid in priority to all other debts. It is also required to be noted at this stage that so far as the dues of the company towards the tax liabilities is concerned, the same would come within Section 530(1)(a) of the Companies Act and as per Section 530(1) of the Companies Act, the said dues as envisaged under Section 530(1)(a), would be subject to the provisions of Section 529(A) and the said dues are to be paid in priority to all other debts subject to the provisions of Section 529(A) of the Companies Act. Therefore, first the amount realized, is to be disbursed to the creditors, as mentioned under Section 529(A) of the Companies Act and they would have a preferential payments. Therefore, also considering Section 529(A) and 530(1)(a) of the Companies Act read with proviso to Section 178(3) of the Act, the workmen's dues and the debts due to secured creditors to the extent such debts rank under clause (c) of the proviso to sub section (1) of Section 529 will have a P*ari Passu* and shall be paid in priority to all other debts. Therefore, the contention on behalf of the applicant that the dues of the Income tax department would have a priority over the secured creditors cannot be accepted and has no substance and the

same is required to be rejected.

11. So far as the reliance placed upon the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra) by the learned counsel appearing on behalf of the applicant is concerned, as stated above, before the Hon'ble Supreme Court, the issue was with regard to *inter se* claim of the creditors under Section 530(1) of the Companies Act and the issue with regard to priority and/or preference over the secured creditors as envisaged under Section 529(A) of the Companies Act, was not there at all. Thus, the question before the Hon'ble Supreme Court was whether the claim of the tax would have precedence over the claim of other creditors under Section 530 of the Companies Act in view of the provisions of subsection (5) of Section 530 of the Companies Act and it is to that extent that the Hon'ble Supreme Court held that an order passed under Section 178 of the Act will prevail over the rights of other unsecured creditors under Section 530 of the Companies Act and therefore, the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited (supra) is not of any assistance to the applicant. Identical questions came to be considered by the Bombay

High Court and Kerala High Court in the cases of Syndicate Bank and etc. (supra) Venad Pharmaceuticals and Chemicals Limited (in liquidation) In re (supra) respectively and considering the decision of the Hon'ble Supreme Court in the case of Imperial Chit Funds (P) Limited as well as the decision of the Andhra Pradesh High Court in the case of Income tax Officer, B-Ward, Company Circle, Hyderabad (supra), the Bombay High Court and Kerala High Court have held that rights of the secured creditors and the workers as set out under Section 529(A) of the Companies Act would override the claim of the tax authorities in respect of order made under Section 178 of the Act. This court is in full agreement with the decisions of the Bombay High Court and Kerala High Court by which the contention of the Income tax department that considering the provisions of Section 178 of the Act, the dues of the Income tax department would have a preference over the secured creditors and the workers, has been negatived.

12. For the reasons as stated above and considering the proviso to Section 178(3) of the Act read with Sections 529(A) and 530 of the Companies Act, the applicant is not entitled to any relief as prayed for and it is required

to be dismissed by holding that the claims of the secured creditors as envisaged under Section 529 of the Companies Act, would have a preference/priority over the dues of the Income tax department, meaning thereby the dues of the Income tax department would not have any preference and/or priority over the claims of the workmen and/or secured creditors as envisaged under Section 529(A) of the Companies Act.

13. Under the circumstances, the present company application is dismissed. No costs.

(M.R.SHAH,J.)

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